BEFORE THE ARIZONA CORPORATION COMMISSION

CARL J. KUNASEK
CHAIRMAN
JIM IRVIN
COMMISSIONER
WILLIAM A. MUNDELL
COMMISSIONER

IN THE MATTER OF INVESTIGATION INTO U S WEST COMMUNICATIONS, INC.'S COMPLIANCE WITH CERTAIN WHOLESALE PRICING REQUIREMENTS FOR UNBUNDLED NETWORK ELEMENTS AND RESALE DISCOUNTS.

DOCKET NO. T-00000A-00-0194 (PHASE I)

DECISION NO. 62753

OPINION AND ORDER

DATE OF HEARING:	May 11, 2000
PLACE OF HEARING:	Phoenix, Arizona
ADMINISTRATIVE LAW JUDGE:	Jerry Rudibaugh
APPEARANCES:	Mr. Thomas Dethlefs on behalf of U SWEST Communications, Inc.;
	Mr. Richard S. Wolters on behalf of AT&T Communications of the Mountain States, Inc.;
	Ms. Mary Steele, DAVIS WRIGHT TREMAINE, LLP, on behalf of NEXTLINK Communications, Inc.;
	Mr. Michael W. Patten, BROWN & BAIN, P.A., on behalf of Cox Arizona Telecom, Inc., Teligent, Inc., e-spire™ Communications; and MGC Communications; and
	Ms. Maureen A. Scott, Staff Attorney, Legal Division, on behalf of the Utilities Division of the Arizona Corporation Commission.

BY THE COMMISSION:

On January 28, 2000, the Arizona Corporation Commission ("Commission") Staff filed a Motion to Reopen Docket or Open a New Sub-Docket ("Motion"). On February 7, 2000, AT&T Communications of the Mountain States, Inc. ("AT&T") and TCG Phoenix filed a Response to Staff's Motion. On February 8, 2000, Cox Arizona Telcom L.L.C. ("Cox") filed Comments on Staff's Motion. On February 14, 2000, U S WEST Communications, Inc. ("U S WEST") filed a Response to Staff's Motion. On February 15, 2000, MCI WorldCom, Inc. ("MCI") filed a Response to Staff's Motion. On February 18, 2000, Sprint Communications Company, L.P. ("Sprint") filed a

Joinder in Comments of AT&T and MCI.

In its Motion, Staff requested the Commission to reopen the generic cost docket or ope. new sub-docket to examine issues raised as a result of: 1) the United States Supreme Court's decision in *AT&T v. Iowa Utils. Bd.*, 119 S.Ct. 721 (1999); 2) the District Court's decision on the Commission's arbitration order regarding the costs of resold retail and wholesale services, *U S WEST v. Jennings*, 46 F. Supp.2d 1004 (D.Ariz. 1999); and 3) the Federal Communications Commission's ("FCC") order lifting the FCC's previous stay of the FCC's rule requiring geographic deaveraging of wholesale rates and order requiring U S WEST to establish rates for line sharing.

AT&T, Cox, MCI, and Sprint all supported Staff's Motion. U S WEST also supported the Motion but did request a new docket be established.

A procedural conference was held on this matter on March 24, 2000. As a result, the above-captioned new docket was opened.

Our March 30, 2000 Procedural Order established that Phase I of this new docket shall be a consolidated arbitration regarding interim geographic deaveraging of wholesale rates. A pr arbitration conference on Phase I was held on May 4, 2000. The arbitration proceeding was held on May 11, 2000. At the arbitration, U S WEST, AT&T, NEXTLINK Communications, Inc. ("NEXTLINK"), and Staff presented testimony in support of their deaveraging proposals. On May 26, 2000, U S WEST, AT&T, NEXTLINK, and Staff filed post-hearing briefs.

DISCUSSION

Introduction

Our March 30, 2000 Procedural Order established a new generic cost docket of which Phase I was designed to comply on an expedited basis with the requirements of 47 C.F.R. Section 51.507(f) ("Section 507(f)"). Because of the expedited nature of the proceeding, it was determined that the rates established in Phase I would be interim subject to a true-up with permanent rates established in a subsequent Phase.

AT&T, U S WEST, and Staff submitted deaveraging proposals. NEXTLINK supported the AT&T proposal. All the parties were in general agreement to the following:

1) The intent of the Telecommunications Act of 1996 ("Act") is to provide competitive

choices to all consumers, regardless of where they live in the state;

2) Section 507(f) requires state commissions to establish rates for unbundled network elements ("UNEs") in at least three defined geographic areas within the state to reflect geographic cost differences; and,

3) The purpose of deaveraging of UNE rates is to minimize implicit subsidies.

The major disagreement among the parties revolved around the existing retail rate structure in Arizona and what impact, if any, should it have on deaveraging of UNE rates. In addition, there were questions regarding the relative timing of wholesale and retail geographic deaveraging as well as consideration of gradualism to minimize rate shock.

U S WEST

U S WEST expressed concerns that movement to wholesale geographic deaveraging prior to retail geographic deaveraging could result in competitive local exchange carriers ("CLECs") having an opportunity for rate arbitrage. For example, the CLECs could purchase UNEs at reduced costs in the urban areas and undercut the retail price of U S WEST. This could result in U S WEST losing low cost customers and with little competition in the rural areas could result in U S WEST becoming an overall high average cost provider.

Because of its belief that wholesale and retail rates are linked, U S WEST proposed geographic rates that are consistent with its retail rate structure. As a result, U S WEST proposed three geographic rates based on its base rate area and the zone increments. U S WEST grouped together costs in each of the three zones and calculated the relative loop investments for each zone. U S WEST utilized its LoopMod model to develop the relative investments by zone. The U S WEST method resulted in a rate of $20.12 for the base rate area (95 percent of access lines); $40.65 for zone one (2 percent of access lines); and $63.70 for zone two (3 percent of access lines).

The U S WEST proposal did not utilize its existing base rate area and zones. Instead, U S WEST utilized an expanded base rate area and zones that it is proposing in the Company's current rate case. At the request of Staff, the Company submitted a late filed exhibit which utilized the Company's proposed methodology with its existing base rate area and zones. The resulting rates are as follows: $18.96 for the base rate area; $34.94 for zone one; and $56.53 for zone two.

U S WEST criticized the AT&T proposal for not considering the existing retail structure. U S WEST opined that the AT&T method was subjective and susceptible to manipulation. According U S WEST, the AT&T method results in five different zones in the Phoenix metro area and could eventually result in a retail rate structure similar to the structure abandoned by the Commission in 1991. In response to concerns expressed by AT&T and Staff, U S WEST asserted it would not charge CLECs for making inquiries or facilities checks and thus CLECs will not be burdened to pay a "look-up" charge to determine a customer's zone.

AT&T

AT&T's proposal established interim geographic deaveraged loop prices in five zones by grouping together wire centers based on loop costs within the wire center. AT&T utilized the HAI Model, version 5.0a, to determine the loop cost by wire center. In general, AT&T grouped wire centers within five dollar increments: Zone one contained wire centers with loop costs between $10 to $15; Zone two between $15 to $20; Zone three between $20 to $25; Zone four between $25 to $30; and, Zone five over $30. This grouping produced the following results:

Zone	Loop Cost	Percent of Lines
1	$12.75	12.0
2	$17.05	58.1
3	$21.98	9.7
4	$27.40	9.4
5	$53.94	10.8

AT&T asserted that the U S WEST proposal only requires that the geographic zones be "related" to cost and not necessarily cost-based. According to AT&T, it is clear from the following language of the "First Report and Order", FCC96-325 (rel. August 8, 1996) that the FCC's definition of cost-related and cost-based were intended to be synonymous:

> *Geographic Deaveraging.* The 1996 Act mandates that rates for interconnection and unbundled elements be "based on the cost. . . of providing the interconnection network elements." We agree with most parties *that deaveraged rates more closely reflect the actual costs* of providing interconnection and unbundled elements. Thus, we conclude that rates for interconnection and unbundled elements be geographically deaveraged.

AT&T also criticized the U S WEST proposal because CLECs would incur an operations supports system inquiry charge to determine the zone a customer was located. AT&T asserted that neither its proposal nor the Staff proposal would require any additional charge. AT&T criticized the Staff proposal for several reasons: 1) the FCC's line counts were inaccurate; and, 2) the FCC did not properly allocate expenses at the element level.

Staff

Staff deaveraged the unbundled loop UNE on a wire center basis using three zones. Staff utilized the FCC Hybrid Cost Proxy Model, Version 2.6, to calculate the loop costs within each wire center. Staff averaged the costs of varying loop lengths and densities across a wire center. Staff then selected three zones based on wire center cost and averaged those costs to determine the average UNE loop rate per zone. Wire centers with loop costs less than $15 were placed in zone one, wire centers with loop costs between $15 and $19 were placed in zone two, and wire centers with loop costs of $19 and higher were placed in zone three. Staff then utilized a multiplier factor of 1.21 to reflect the difference in the FCC's statewide average cost of $18.17 and the Commission's approved statewide average rate of $21.98. The groupings produced the following results:

Zone	Loop Cost	Percent of Lines
1	$16.95	20
2	$19.97	59
3	$32.41	21

Analysis

Staff and AT&T have presented plans that reflect actual costs better than the U S WEST proposal. However, we concur with U S WEST that Commission policy in setting retail rates needs to be taken into consideration in setting geographic deaveraged UNE rates. To do otherwise, U S WEST could have retail rates which may not be cost based but would have to compete with wholesale rates which would be cost based. As a result, we will approve the U S WEST methodology for establishing three geographic deaveraged rates at this time. We approve the methodology with the understanding that U S WEST shall not charge CLECs for making inquires to determine the zone a customer has located. However, those deaveraged rates should be based on the current retail zone structure and not the zone structure proposed by U S WEST in its current rate ca. Instead of expanding the current retail zone structure in the upcoming U S WEST rate case, it would be more appropriate to begin to gradually make the rate structure more cost based. We believe such cost based movement is consistent with the objectives of the Act.

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Having considered the entire record herein and being fully advised in the premises, the Commission finds, concludes, and orders that:

FINDINGS OF FACT

1. On August 8, 1996, the FCC adopted rules implementing Sections 251 and 252 of the Act.

2. 47 C.F.R. Section 51.507(f) required state commissions to establish a minimum of three geographic rate zones for UNEs and interconnection that reflect cost differences.

3. The Eighth Circuit Court of Appeals subsequently stayed large portions of the FCC rules, including Section 51.507(f), and on July 18, 1997, it vacated the rules on jurisdictional grounds.

4. On January 25, 1999, the United States Supreme Court reversed the Eighth Circuit's jurisdictional holdings.

5. As a result, the FCC rules that had been vacated on jurisdictional grounds, including Section 51.507(f), were subsequent reinstated.

6. On May 7, 1999, the FCC issued a *sua sponte* Order, FCC 99-86 (14 FCC Rcd. 8300) stay of the effectiveness of Section 51.507(f), "until six months after the Commission issues its order in CC Docket No. 96-45 finalizing and ordering implementation of high-cost universal service support for non-rural local exchange carriers (LECs) under section 254 of the Communications Act of 1934, as amended."

7. On November 2, 1999, the FCC issued its Ninth Report and Order and Eighteenth Order on Reconsideration in the Universal Service Docket in which it expressly lifted the stay of t deaveraging requirement effective May 1, 2000.

8. On January 28, 2000, the Commission Staff filed a Motion.

9. In its Motion, Staff requested the Commission to reopen the previous generic cost docket or open a new sub-docket to examine issues raised as a result of: 1) the United States Supreme Court's decision in *AT&T v. Iowa Utils. Bd.*, 119 S.Ct. 721 (1999); 2) the District Court's decision on the Commission's arbitration order regarding the costs of resold retail and wholesale services, *U S WEST v. Jennings*. 46 F. Supp.2d 1004 (D.Ariz. 1999); and 3) the Federal Communications Commission's ("FCC") order lifting the FCC's previous stay of the FCC's rule requiring geographic deaveraging of wholesale rates and order requiring U S WEST to establish rates for line sharing.

10. AT&T, Cox, MCI, and Sprint all supported Staff's Motion. U S WEST also supported the Motion but did request a new docket be established.

11. A procedural conference was held on this matter on March 24, 2000.

12. Our March 30, 2000 Procedural Order established that Phase I of this new docket shall be a consolidated arbitration regarding interim geographic deaveraging of wholesale rates.

13. The arbitration proceeding was held on May 11, 2000.

14. At the arbitration, U S WEST, AT&T, NEXTLINK, and Staff presented testimony in support of their deaveraging proposals.

15. All the parties were in general agreement to the following:

- The intent of the Act is to provide competitive choices to all consumers, regardless of where they live in the state;
- Section 507(f) requires state commissions to establish rates for UNEs in at least three defined geographic areas within the state to reflect geographic cost differences; and
- The purpose of deaveraging of UNE rates is to minimize implicit subsidies.

16. Deaveraged rates more closely reflect the actual costs of providing interconnection and unbundled elements.

17. U S WEST's proposed geographic deaveraging for UNEs would result in a rate of $18.96 for the base rate area; $34 94 for zone one, and $56.53 for zone two.

18. U S WEST will not charge CLECs for making inquires or facilities checks to determine the zone a customer was located.

19. The U S WEST proposal requires that the geographic zones be "related" to cost.

20. Staff and AT&T presented plans that reflect costs better than the U S WEST proposal.

21. Commission policy in setting retail rates needs to be taken into consideration in setting geographic deaveraged UNE rates.

22. One of the objectives of the Act is to gradually have cost-based rates.

CONCLUSIONS OF LAW

1. U S WEST is a public service corporation within the meaning of Article XV of the Arizona Constitution.

2. U S WEST is an ILEC within the meaning of 47 U.S.C. Section 252.

3. The Commission has jurisdiction over the parties and the subject matter of this proceeding.

4. It is reasonable to approve the U S WEST methodology for establishing three geographic deaveraging rates at this time and approve the interim rates set forth in Findings of Fact No. 17 subject to a true-up mechanism.

ORDER

IT IS THEREFORE ORDERED that the Commission hereby adopts and incorporates as its Order the resolution of the issues contained in the above Discussion.

IT IS FURTHER ORDERED that the geographic rates for unbundled network elements established herein are interim and subject to refund at the time permanent rates are established in Phase II of this Docket.

IT IS FURTHER ORDERED that U S WEST Communications, Inc. shall file within thirty days of the date of this Decision, a schedule setting forth rates and charges approved herein.

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IT IS FURTHER ORDERED that the rates and charges approved herein shall be effective immediately.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRMAN | COMMISSIONER | COMMISSIONER

IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Secretary of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this 25th day of July, 2000.

BRIAN C. McNEIL
EXECUTIVE SECRETARY

DISSENT ______________

SERVICE LIST FOR: GENERIC INVESTIGATION

DOCKET NO. T-00000A-00-0194

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